County of Los Angeles
CHIEF EXECUTIVE OFFICE
713 KENNETH HAHN HALL OF ADMINISTRATION
LOS ANGELES, CALIFORNIA 90012
(213) 974-1101
http://ceo.lacounty.gov

WILLIAM T FUJIOKA
Chief Executive Officer

January 31, 2008

To: Supervisor Yvonne Burke, Chair
Supervisor Gloria Molina
Supervisor Zev Yaroslavsky
Supervisor Don Knabe
Supervisor Michael D. Antonovich

From: William T Fujioka
Chief Executive Officer

RESPONSE TO LEGAL AID FOUNDATION OF LOS ANGELES LETTER DATED JANUARY 25, 2008, REGARDING THE MARINA DEL REY AFFORDABLE HOUSING POLICY

This memorandum is to transmit the County's responses (Attachment A) to issues raised by the Legal Aid Foundation of Los Angeles (LAFLA) in its letter dated January 25, 2008, (Exhibit I) regarding the Marina del Rey Affordable Housing Policy. The responses were prepared in consultation with the Department of Beaches and Harbors, County Counsel and the County's real estate and economic consultants. As you are aware, the Marina del Rey Affordable Housing Policy is scheduled to be considered at your Board's next public meeting on Wednesday, February 6, 2008.

If you have any questions regarding the attached responses, I can be reached at (213) 974-1101 or your staff may contact John Edmisten at (213) 974-7365.

WTF:DL
JSE:mc

Attachments

Attachment A

MARINA DEL REY AFFORDABLE HOUSING POLICY RESPONSE TO LEGAL AID FOUNDATION OF LOS ANGELES

1. Determining Feasibility on a Project-by-Project Basis

The Housing Advocates believe the draft policy should be amended to provide for a presumption that the inclusionary housing goals set forth in the draft policy can be met unless the developer provides substantial evidence that meeting those goals is infeasible. In a legal opinion prepared by the State Department of Housing and Community Development (DHCD) for implementation of the Mello Act, DHCD advises that local governments may either conduct a feasibility analysis on a case-by-case basis for individual projects or conduct a comprehensive study to establish set inclusionary housing requirements in advance. Given the small number of residential projects anticipated in the Marina in the near future, and the cost and consumption of time of conducting a full feasibility analysis, staff recommended a feasibility analysis for each project be completed. Coupled with goals that provide developers with the County's affordable housing objectives, we believe this position is legally defensible and consistent with the Mello Act provisions regarding feasibility and is a matter of policy for your Board's consideration. To date, all new residential projects currently being contemplated in Marina del Rey will meet the goals set forth in the draft policy as a result of significant financial contributions from the County in the form of rent credits. In order to incorporate a presumption in the draft policy as suggested by the Housing Advocates the County would first have to conduct a comprehensive study to support that presumption. We do not recommend proceeding in that manner as it will further delay implementation of the affordable housing policy.

2. Affordable Housing Eligibility for Replacement Units

In the absence of tenant income information, Legal Aid is suggesting that household size be taken into consideration along with the average monthly rental rates to determine the number of required replacement units. This is contrary to the manner in which family size is used as a factor under State affordable housing income and rent calculations. Under the Mello Act, the number of replacement units is determined based upon the income level of the current occupants of each existing unit that will be demolished or converted. Under State affordable housing law, qualifying income levels are set based upon a percentage of median income adjusted for family size. Therefore, family size used in conjunction with income data of the current occupants will determine qualification of an existing unit as a replacement unit when the tenant or landlord provides the income and family size information. Under the draft policy, if the tenant does not provide the income data and it is not available from the landlord, the determination of whether or not a unit must be replaced with an affordable unit is determined by comparison of the average of the previous year's monthly rent for the unit to the average affordable monthly rental rate for the same year.

Under State affordable housing law, affordable rental rates are based upon a presumed number of occupants per bedroom (1 person per studio, 2 persons per one-bedroom, 3 persons per two-bedroom, etc.). Therefore, by comparing a one bedroom market rate unit rent to the affordable rent for a one bedroom, the presumed family size is taken into consideration. Actual family size is taken into consideration when the tenant or landlord provides the income information requested, but in the absence of accurate information from the tenant or landlord regarding family size and income, we believe that average monthly rent is a reasonable proxy. We do not recommend revising the draft policy in the manner suggested as the draft policy takes family size into consideration as set forth above. If tenants want their actual family size taken into consideration, they should respond to the survey.

3. Off-site units

The Housing Advocates believe that the draft policy's allowance of "substantial rehabilitation" for off-site Mello Act compliance is problematic because it will not add new units to the County's housing stock and the term is not defined in the draft policy, and because it is cheaper than adaptive re-use and new construction, making it the preferred alternative. While we agree that adaptive reuse and new construction will increase the County's housing stock, the aim of the Mello Act is to increase the number of affordable housing units in the coastal zone. Substantial rehabilitation of an existing market rate apartment complex to designated affordable housing is one way to achieve the stated goal and thus should not be discarded as an option to comply with the Mello Act requirements. "Substantial rehabilitation" is a common term in State housing and redevelopment law and is generally defined as a rehabilitation in which the costs of rehabilitation equal or exceeds 20 percent of the value of the structure after rehabilitation. As such, we recommend that the draft policy be revised to include a definition of substantial rehabilitation consistent with State Law.

4. Term of Affordability

We agree with Legal Aid that the term of affordability should be clarified. Therefore, we recommend Item 4 (b) and Item (14) of the draft policy be changed to reflect that the affordability covenant should be applicable through the "term of the ground lease".

5. Feasibility Methodology and Threshold

Legal Aid proposes that the draft policy contain a specified threshold rate of return and the specified rate of return be considered the "minimum" required return demanded in the market. The draft policy includes an independent third party measure of the value of apartment projects (the California Real Estate Journal) and a maximum allowance of 200 basis points to allow for developer profit and the loss in value associated with affordable housing units and a ground lease. Rather than picking a specific threshold, the draft policy allows for adjustments in market conditions so that the County is not required to over subsidize projects during good economic times, which would be the case if the

10% return threshold from the previous policy was still applicable. The County has previously demonstrated that its methodology results in a similar or lower return on cost for apartment projects than does the Los Angeles Housing Department methodology endorsed by Legal Aid (see Keyser Marston Associates, Inc. memorandum dated June 18, 2007) Exhibit II.

6. Definition of a "Unit"

We concur with Legal Aid's contention that the definition of "unit" should be amended to include "studios". Accordingly, we recommend that section 11(c) be amended to read: "A 'unit' shall consist of one or more rooms, one of which will include a kitchen ...." The purpose of the "unit" definition was to ensure that all standard amenities that come with an apartment (access to laundry facilities, janitor service, maintenance and repair, garbage collection, parking, etc.) would be included in the affordable rent and not subject to separate charges. The intention of the definition was not to exclude studios as potential affordable units.

7. Ownership Units

The Housing Advocates propose that the draft policy require like-for-like tenure of units (i.e., if a new development is an ownership development, affordable units should also be ownership units). There is no obligation under the Mello Act that requires like-for-like tenure of units. Moreover, the vast majority of residential units in Marina del Rey are rental units. There is only one existing development, the Marina City Club, that contains long-term residential subleases (condominiums), and one proposed development, Parcel 64, which proposes long-term residential subleases. The Marina City Club has a component that includes market rate rental apartments, and Parcel 64 contemplates both a component with market rate and affordable apartment units. Thus, we do not believe the Housing Advocates' arguments of "ghettoization" and "stigmatization" are valid. Further, administration of affordable ownership units is cumbersome both because the subsidy is an upfront cost and because the affordable ownership units must be monitored to ensure that all transfers of the ownership units comply with the affordable housing covenant requirements. Finally, for the type of development contemplated on Parcel 64, the only proposed development likely to involve this issue, the excessive cost to subsidize an ownership unit at approximately $1.2 million per unit compared to a rental unit at approximately $200,000 per unit, is cost prohibitive without significant additional subsidy from the County.

8. Tenant Questionnaire

The Housing Advocates would like to delete the "Decline to State" option from the tenant questionnaire and require the developer to make a minimum of three good faith attempts to obtain a completed questionnaire from each tenant. The "Decline to State" option is necessary to track responses received from individuals not interested in participating in the survey or filling out the tenant questionnaire. Under the draft policy, the Community Development Commission (CDC), not the developer, will be principally responsible for the tenant surveys.

However, we agree that the CDC should use reasonable efforts to secure tenant income information to determine affordable housing eligibility. Therefore, we recommend that language requiring CDC to use reasonable efforts be included in the draft policy.

9. <u>Failure to Ensure Compliance with the Mello Act's Fundamental Inclusionary Requirement</u>

The Housing Advocates assert that the Mello Act requires that a developer provide as many affordable housing units as it is feasible to provide. The Mello Act does not set forth any percentages, minimum number of units, or other formulas for complying with the inclusionary housing requirement. The determination of whether or not inclusionary affordable housing is "feasible" and the number of inclusionary units to be provided is left to the discretion of the local agency implementing the Mello Act. The Mello Act defines "feasible" as "capable of being accomplished in a successful manner within a reasonable period of time, taking into account economic, environmental, social and technical factors." Thus, a number of factors must be weighed by the local agency in determining whether inclusionary housing is feasible and the extent to which it must be provided, if feasible, in each project to which the Mello Act is applicable. The draft policy requires a feasibility analysis for each project, and while the policy sets goals of five percent low and five percent moderate of the net new units, these amounts may change based upon the feasibility analysis on a case-by-case basis. The Housing Advocates contention that this approach is flawed is inconsistent with the Mello Act and the DHCD legal opinion cited in item 1, above. The Mello Act does not require that the County adopt a policy or ordinance to implement its provisions, nor does it require a comprehensive feasibility analysis. Determining feasibility on a case-by-case basis is entirely consistent with the statute. County Counsel has advised that the Housing Advocates' comparison of the feasibility provision in the Mello Act to the feasibility provision in the California Environmental Quality Act ("CEQA") is inapposite, as the case law cited questions the evidence (or lack of evidence) supporting determinations of infeasibility, not the quantity or quality of mitigation measures determined to be required to avoid or substantially lessen the significant effects of a proposed project. To the extent that CEQA acknowledges that there may be a range of feasible alternatives and mitigation measures, that such alternatives or mitigation measures may not entirely avoid a significant effect, and that if project alternatives and mitigation measures are infeasible, projects may still be approved in spite of their significant effects, lends credence to our belief that determinations of feasibility under CEQA or the Mello Act are discretionary matters that take into consideration a number of factors, the outcome of which cannot simply be mandated in advance in the manner suggested by the Housing Advocates. It should be noted that the County's economic experts have determined that all residential projects currently under consideration are infeasible if the developer itself were required to absorb the entire economic consequences of providing the inclusionary unit goals contained in the policy, and that it is only with significant financial contributions from the County in the form of rent credits that any inclusionary affordable housing is feasible in these projects.

LEGAL AID FOUNDATION OF LOS ANGELES

ATTORNEYS AT LAW
110 Pine Avenue, Suite 420
Long Beach, California 90802-4421
Telephone: (562) 435-3501
Fax: (562) 435-7118

Central Office
1550 W. Eighth Street
Los Angeles, CA 90017-4316
(213) 640-3881

East Office
5228 E. Whittier Boulevard
Los Angeles, CA 90022-4013
(213) 640-3883

Santa Monica Office
1640 Fifth Street, Suite 124
Santa Monica, CA 90401-3343
(310) 899-6200

South Central Office
8601 S. Broadway
Los Angeles, CA 90003-3319
(213) 640-3884

West Office
1102 Crenshaw Boulevard
Los Angeles, CA 90019-3111
(323) 801-7989

Writer's Direct Dial Number (562) 304-2520

sbrowne@lafla.org

January 25, 2008

Supervisor Gloria Molina
Supervisor Yvonne Burke
Supervisor Zev Yaroslavsky
Supervisor Don Knabe
Supervisor Michael Antonovich
856 Kenneth Hahn Hall of Administration
500 W. Temple Street
Los Angeles, CA 90012

Re: **Comments re: November 16, 2007 Affordable Housing Policy**

Dear Honorable Supervisors:

The Legal Aid Foundation of Los Angeles submits this letter on behalf of our colleagues at the Western Center on Law and Poverty and our client, People Organized for Westside Renewal (POWER), regarding the proposed Affordable Housing Policy, dated November 16, 2007. The proposed Policy raises many issues not previously discussed by the Board of Supervisors during public hearings. Please refer to the October 4, 2007 letter from our colleagues at the Western Center on Law and Poverty for our comments regarding the Negative Declaration.

1. <u>Determining Feasibility on a Project-by-Project Basis</u> (Pages 2, 10)

The proposed Policy recommends that feasibility determinations be made on a project-by-project basis. By itself, this creates greater uncertainty and unpredictability as to the County's Mello requirements. In addition, the proposed Policy treats the 5% low income and 5% moderate income inclusionary housing standards as goals rather than as minimum levels presumed by the County to be feasible. This approach strips any meaning from the numeric standards and thus provides little guidance to interested parties. This approach is also likely to lead to protracted battles regarding each individual development in the Marina.

The Policy should be amended to provide for a presumption that the housing production numbers can be met unless a developer provides substantial evidence that meeting those numbers is infeasible.

2. Affordable Housing Eligibility for Replacement Units (Page 6)

Under the proposed Policy, if a tenant fails to provide income data, the County will examine the average monthly rent for the unit for the previous year and compare this to average affordable monthly rental rates for the same year. It is critical, however, that the County also takes into consideration household size when determining whether rental rates are affordable. Household size is an important factor because low or moderate income tenants may be doubled up to afford market rents.

The proposed Policy should be amended to require that household size be taken into consideration when determining whether the rent for a unit is an affordable monthly rent.

3. Off-site units (Pages 9,11)

The proposed Policy allows developers to satisfy their Mello obligations off-site through new construction or substantial rehabilitation. Substantial rehabilitation is problematic for three reasons. First, substantial rehabilitation does not add new units to the County's housing stock. Second, substantial rehabilitation is not defined anywhere in the Policy, making it unclear and open to abuse. Third, substantial rehabilitation is cheaper than adaptive re-use and new construction. Developers, therefore, will have an economic incentive to opt for off-site substantial rehabilitation of units.

The proposed Policy should be amended to allow developers to satisfy off-site Mello obligations only through adaptive re-use and new construction, as these methods will increase the County's affordable housing stock.

4. Term of Affordability (Pages 8,12)

The proposed Policy allows for a term of affordability equal to the "term of the lease." It is not clear whether the proposed Policy refers to the ground lease or the sublease of the unit in question. Of course, the latter – which could be as short one month – would be unacceptable. The former is problematic because it could lead to a situation in which a lessee renegotiates its ground lease after only a short time, thereby eliminating their Mello obligations. The approach which provides the greatest assurance that affordable units will remain in the Marina would simply be to require affordability for the life of the project.

5. Feasibility Methodology and Threshold (Pages 8, 10)

The proposed Policy (at Sec. 6(a)ii. and 10(a)(ii)) sets forth requirements for a project's feasibility analysis as follows:

> "An estimate of the developer's return that would be generated by the project. This return will be compared to a feasibility factor equal to the capitalization rate for apartment sales in Los Angeles County, as published in the California Real Estate Journal, plus an amount not to exceed 200 basis points."

This approach to feasibility analysis is fundamentally flawed. First, it does not provide a practical or logical way to establish a threshold against which to compare the return on a given project. The proposed Policy therefore fails to set out a measure of a "developer's return" for comparison against the "feasibility factor." Simply having a capitalization rate to look at does not indicate what the threshold should be for NOI/TDC (the threshold measure used in the existing Policy) or for Internal Rate of Return (IRR).

Historical experience strongly suggests that, without proper guidance, the County will improperly inflate the feasibility threshold. The existing policy and the County's application of that policy in the Del Rey Shores case attempted to establish such thresholds. The original policy simply asserted annual return on cost (NOI/TDC) was the right measure and that a good threshold for NOI/TDC was 10% (back in 2002). (See August 6, 2002 Policy at 7). As we have noted in our prior submissions to the County, this level translates into an excessively high IRR.

In each project-by-project feasibility analysis, the threshold chosen is crucial. And the proposed Policy, while it purports to establish a threshold, it does not.

The proposed Policy also provides for a cushion of up to 200 basis points, but provides no grounds for selecting a particular number between 0 and 200 in a specific case. In prior cases, the County has needlessly adjusted the feasibility threshold by as much as 150 basis points to allegedly compensate for: (1) the fact that the project could expect less appreciation than a fully market rate project because some units are rent restricted; and (2) the fact that the land will be leased for less than 60 years, rather than owned fee simple by the developer. Under the proposed Policy, however, 90% of units can obtain increased market rents. Based on the County's own analysis in the Del Rey Shores case, which says that 100% affordable projects have return requirements that are 100 basis points higher than 100% market-rate projects, the appreciation-related adjustment should be only 10% of 100 basis points, or 10 basis points.

As to the lease issue, the only disadvantage of a ground lease in lieu of fee simple ownership is that the developer (or some future owner of the improvements) may not be able to obtain the net income that would accrue after the lease expires (depending on what occurs after expiration). Suppose we assume the extreme case that the developer in this case receives no further income or capital payment for the apartments after 60 years. We compare the 60-year stream of net operating income received in the leasing case with 100 years of revenue in the land ownership case. We computed the present value of the 60 year stream of NOI and compared it with that of the 100 year stream, using a discount rate of 8% (County consultant KM&A's rate of expected return on real estate projects). The 60 year leasehold yields a present value that is 99% of the 100 year level. That percentage falls only very slightly if the land ownership project is assumed to last even longer than 100 years. Thus the developer should seek a 1% higher return rate for a project with a 60 year lease, at the most. Even assuming the 1% is 1% of an 8% base return, this is only 8 basis points.

Accordingly, to properly account for the only two issues previously identified by the County to justify upward adjustment in the threshold, only an additional 20 basis points are necessary.

The proposed Policy, in sum, should be amended to include:

- A specification of its measure of return
- A threshold level for that measure
- A rationale for that threshold demonstrating that the threshold is indeed the minimum demanded in the market
- A 20 basis point cushion with clear criteria for applying additional basis points.

6. <u>Definition of A "Unit"</u> (Page 12)

The proposed Policy defines a "unit" in such a way that it does not include studios. Studios should not be exempted from the Mello Act's replacement housing obligations, and the County has provided no reason for their exemption.

The definition of "unit" should be amended in the proposed Policy, or deleted, to ensure that studios are not exempted from replacement housing obligations.

7. <u>Ownership Units</u> (Page 13)

The proposed Policy allows developers to satisfy their Mello obligations by providing affordable rental units in ownership developments. This provision should be changed for a number of reasons. First, the proposed policy should encourage, not discourage, the creation of affordable home ownership opportunities. Second, the proposed Policy allows developers to minimize their Mello obligations because it is cheaper for developers to provide affordable rental units. Finally, the proposed Policy is likely to lead to the ghettoization and stigmatization of affordable units because they will be different from other units in the development.

The proposed Policy should be amended to require like-for-like tenure of units. In other words, if a new development is an ownership development, affordable units should also be ownership units. Similarly, if a new development is partially rental and partially ownership, the affordable units should be partially rental and partially ownership.

8. Tenant Questionnaire

The Tenant Questionnaire should be revised in two ways.

First, the "Decline to State" option should be deleted. This option encourages tenants not to fill out the Questionnaire. The Mello Act requires that replacement housing obligations be determined through an examination of tenant incomes. Every effort should be made, therefore, to ensure that tenant income information is in fact obtained.

Second, the Questionnaire is silent regarding how many attempts a developer must make to obtain a completed Questionnaire from a tenant. The proposed Policy should be amended to include a requirement that developers make a minimum of three good faith attempts to obtain completed Questionnaires from each tenant.

9. Failure to Ensure Compliance with the Mello Act's Fundamental Inclusionary Requirement.

The proposed Policy fails to ensure compliance with the Mello Act's inclusionary housing requirement.

A. The Mello Act Requires Developers to Include as Many Affordable Units as Are Feasible in a Residential Project to which the Act Applies.

The Mello Act states, "[n]ew housing developments constructed within the coastal zone shall, where feasible, provide housing units for persons and families of low or moderate income." Cal Gov't Code § 65590(d). Properly read, this provision of the Act requires a developer to provide as many affordable housing units for persons and families of low or moderate income as it is feasible to provide. As a practical matter, because it is the local jurisdiction – here, the County – who will apply the statutory requirement, Cal Gov't Code § 65590(a), it must make a determination as to the number of affordable units that may feasibly be provided at such a project and then require that the project provide that number of affordable units. "Feasible" is defined in the Act as "capable of being accomplished in a successful manner within a reasonable period of time, taking into account economic, environmental, social and technical factors." Cal. Gov't Code § 65590 (g)(3).

1. Reading § 65590(d) in Light of the Purpose of the Mello Act and Related Statutes Compels the Conclusion that the Provision Requires the Provision of as Much Affordable Housing as Possible.

In analyzing a statute, courts first attempt to ascertain the intent of the legislature so as to effectuate the purpose of the law. *Dyna-Med, Inc. v. Fair Employment and Housing Commission*, (1987) 43 Cal. 3d 1379, 1386. The Legislative Digest accompanying the adopted version of the Mello Act notes that the California Coastal Act's planning and management policies "among other things, provide that housing opportunities for persons and families of low or moderate income shall be protected, encouraged and, where feasible, provided." Legislative Digest, Senate Bill 626, as Amended on Sept. 14, 1981. The Digest describes the Mello act as strengthening the policies by preventing jurisdictions from authorizing the conversion or demolition of affordable dwellings without providing for replacement thereof and by requiring new housing developments to provide affordable housing. *Id.*

A review of the Mello act's evolution as a bill reveals that the legislature considered and abandoned less forceful inclusionary housing requirements. The April 27, 1981 draft of SB626 deemed any proposed housing development in compliance with an adopted housing element to be in compliance with the statute. For jurisdictions that had not adopted a housing element, the bill required applicants to *either* provide replacement or inclusionary housing. (emphasis added) That same version's inclusionary provision required applicants to "provide for new housing opportunities for persons and families of low or moderate income in new housing developments in the coastal zone pursuant to Chapter 4.3 (commencing with Section 65915), where feasible." Notably, the bill stated, "such housing opportunities *may* be located within the development." (emphasis added.) The June 8, 1981 version of the bill included replacement and inclusionary provisions as part of a program required "*to the extent necessary*, to meet the jurisdiction's share of the regional housing need as determined in accordance with Section 65584." (emphasis added). This version stated that inclusionary units "*may* be located within the development, *if feasible*." (emphasis added). By contrast, the adopted version contains a stand-alone requirement that project applicants include affordable housing within their projects and features more potent language regarding the provision and location of units:

> "[n]ew housing developments constructed within the coastal zone *shall*, where feasible, provide housing units for persons and families of low or moderate income . . . Where it is not feasible to provide these housing units in a proposed new housing development, the local government *shall* require the developer to provide such housing, if feasible to do so, at another location within the same city or county, either within the coastal zone, or within three miles thereof."

Cal Gov't Code § 65590(d) (emphasis added). Comparing the adopted version with those that preceded it reveals that the legislature first considered an approach that would have used a jurisdiction's share of the regional housing need as a baseline for determining whether to apply inclusionary housing requirements to projects. That the legislature adopted an independent inclusionary housing requirement for all coastal zone projects, regardless of the regional housing need, while simultaneously adopting more vigorous language within the inclusionary provision, strongly suggests the legislation was intended to obtain as much affordable housing as possible.

Courts also require that statutes or statutory sections relating to the same subject must be harmonized, both internally and with each other, to the extent possible. *California Mfrs. Assn. v. Public Utilities Com.* (1979) 24 Cal.3d 836, 844. In the statute relating to the housing element of local land use plans, to which early draft versions of the Mello act were originally connected, see, e.g., April 27, 1981 draft of SB626, the legislature has declared that, "the lack of housing is a critical problem that threatens the economic, environmental, and social quality of life in California." Cal Gov't Code § 65589.5(a). In particular, the statute is concerned with reducing "[t]he excessive cost of the state's housing supply" by addressing "activities and policies of many local governments" that reduce the supply of housing. *Id.* The Legislative Digest accompanying the Housing Element statute notes, "[e]xisting law . . . declares that it is the policy of the state that a local government not reject or make infeasible affordable housing developments that contribute to meeting the state housing need without a thorough analysis of the effects of the action" 2006 Cal ALS 888. Thus, one important objective of the legislature in this arena seems to be expanding the short supply of affordable housing by ensuring its feasibility. To harmonize § 65590 with this purpose, the statute must be read to say that where affordable housing may feasibly be included in a development, it must be included.

As noted, the Legislative Digest accompanying the adopted version of the Mello act states that the statute exists in part to effectuate the policies of the California Coastal Act. Among the "Basic Goals" of the California Coastal Act at the time of the enactment of the Mello Act was, "[m]aximiz[ing] public access to and along the coast . . . . consistent with sound resources conservation principles and constitutionally protected rights of private property owners." Reading § 65590(d) in connection with this language leads to two important results. First, it suggests that the provision should be read so as to "maximize" public access to the coast. Second, it invites the possibility that the legislature may have intended the phrase "where feasible" to ensure that a statute that otherwise mandates the inclusion of affordable housing does so only to an extent that does not work a constitutionally prohibited taking of property.

The Mello Act, the housing element law and the California Coastal Act all advance principles that harmonize easily: promoting housing for low and moderate income residents in the coastal zone; expanding the supply of affordable housing; and maximizing public access to the coast. "Giving the language its usual, ordinary meaning and according significance, if possible, to every word, phrase and sentence in pursuance of the legislative purpose," *Dyna-Med,* 43 Cal. 3d at 1387, as set forth above, § 65590(d) must be read to say that where it is feasible to provide affordable housing in a project in the coastal zone, that housing must be provided.

2. California Courts Applying the Same Feasibility Standard in the CEQA Context Categorize Development Models as "Feasible" So Long as They Do Not Render the Project Totally Impractical.

California courts analyzing legislative language look to case law interpreting similar statutory schemes. *See Dyna-Med, Inc. v. Fair Employment and Housing Commission,* (1987) 43 Cal. 3d 1379, 1390 (comparing court's reading of a different statute on the same interpretive issue). Further, courts seek to harmonize interpretations of analogous statutes. *See id.* at 1391-92 (noting favorably that a particular statutory construction harmonized provision with analogous provisions in other statutes). Under the California Environmental Quality Act (CEQA), "public agencies should not approve projects as proposed if there are feasible alternatives or feasible mitigation measures available which would substantially lessen the significant environmental effects of such projects . . . ." Cal. Pub. Resources Code § 21002. Under CEQA, as under the Mello Act, "feasible" is defined as "capable of being accomplished in a successful manner within a reasonable period of time, taking into account economic, environmental, social and technological factors." Cal. Pub. Resources Code § 21061.1; CEQA Guidelines, § 15364.

Notably, CEQA, which states that public agencies "should" not approve projects if there are feasible mitigation measures, Cal. Pub. Resource Code § 21002, is less forceful in requiring "feasible" mitigation measures than the Mello Act, which states that new housing developments "shall" provide affordable housing units, "where feasible," Cal Gov't Code § 65590(d). Yet California courts applying § 21002 have set a strict standard for local governments contending that particular mitigation measures were not feasible. In *Uphold Our Heritage v. Town of Woodside*, the court of appeal wrote that a showing of financial feasibility requires "evidence that the additional costs or lost profitability are sufficiently severe as to render it impractical to proceed with the project." (2007) 147 Cal. App. 4th 587, 599 (*quoting Citizens of Goleta Valley v. Board of Supervisors*, (1988) 197 Cal. App. 3d, 1167, 1181); *see also Preservation Action Council v. City of San Jose*, (2006) 141 Cal. App. 4th 1336, 1357 (following *Goleta* to conclude that reduced size retail store alternative was not infeasible because City had not shown it would be "so much less profitable and produce so many fewer tax dollars that the project would be impractical"). Adopting this interpretation of the term "feasible" in reading the Mello Act's inclusionary housing provision, Cal Gov't Code § 65590(d), supports reading of that provision that requires new housing developments constructed within the coastal zone to provide housing units for persons and families of low or moderate income to the extent that doing so does not render the project impractical to construct. This interpretation is consistent with those compelled by the statutory purposes of the Mello Act and related statutes described above; both require a project to provide as much affordable housing as possible.

3. Readings of the Statute Allowing for Fewer Affordable Units Eviscerate the Statute's Meaning.

Where uncertainty exists, consideration should be given to the consequences that will flow from a particular interpretation. *Alford v. Pierno* (1972) 27 Cal. App. 3d 682, 688 Relying on the absence of a specific numeric or percentage requirement in § 65590(d) along with the "where feasible" clause, some observers have concluded that the provision is sufficiently general to allow a municipality to approve a project containing an amount of affordable housing that is less than what it is feasible for the project to contain. For example, County Counsel have, in discussions, adopted the position that "any feasible amount" of housing will satisfy §65590. Under this interpretation, if a 100 unit project could feasibly include 10 units of affordable housing, the County could require the developer to provide only 1 unit of affordable housing, because any number between 0 and 10 would be "feasible." First, this interpretation is inconsistent with the Mello Act's mandate that projects contain affordable housing where feasible; it requires the §65590(d) to read, "[n]ew housing developments constructed within the coastal zone *may*, where feasible, provide housing units for persons and families of low or moderate income."

Second, statutes are to be given a reasonable and commonsense interpretation consistent with apparent legislative purpose and intent "and which, when applied, will result in wise policy rather than mischief or absurdity." *Honey Springs Homeowners Assn. v. Board of Supervisors* (1984) 157 Cal. App. 3d 1122, 1136, fn. 11. This interpretation not only flies in the face of the statutory purpose, but, as the example shows, it renders §65590 meaningless in jurisdictions that elect simply to require no affordable housing in projects to which the provision applies. Finally, this interpretation gives virtually unlimited discretion to jurisdictions to require an amount of affordable housing that is based on considerations totally unrelated to what amount is feasible as defined by the statute. The result is almost certainly arbitrary and disparate application of the statute across jurisdictions and across cases within the same jurisdiction.

In sum, § 65590(d) must be read to require a developer to whose project the Mello act applies to provide as many affordable housing units for persons and families of low or moderate income as it is feasible to provide.

B. The Proposed Policy Fails to Ensure that The County Will Require As Much Affordable Housing As Feasible.

The proposed Policy affords the County with flexibility in implementing the Mello Act that in some cases may result in violations of the basic inclusionary requirement of §65590(d). First, the proposed Policy adopts a project-by-project approach to feasibility analysis, declining to set minimum inclusionary levels presumed to be feasible. This approach, which differs from the County's existing policy and from the City of Los Angeles' Policy, places nearly all the burden on the County's feasibility analysis to ensure compliance with §65590(d). Yet, as set forth in detail above, the methodology set forth in the proposed Policy clearly fails to provide any assurance that the County will, in fact, require anywhere near the level of inclusionary housing that is feasible, and therefore required, at the project. The Proposed policy fails to provide: (a) specification of its measure of return; (b) a threshold level for that measure; and (c) a rationale for that threshold demonstrating that the threshold is indeed the minimum demanded in the market. Moreover, the proposed Policy unnecessarily allows for as much as a 200 basis point upward adjustment of the feasibility threshold without any clear criteria for applying the additional basis points. In any given case, a rational profit-maximizing developer will seek an inappropriately high feasibility threshold and the County will have inadequately established standards by which to challenge the developer's analysis. All told, the proposed Policy provides sweeping discretion to the County, little guidance to interested parties and absolutely no assurance that the fundamental inclusionary standard of § 65590(d) will be met.

Accordingly, in order to assure compliance with § 65590, the proposed Policy should be amended to: (a) increase and strengthen the minimum inclusionary requirements (by increasing the percent of affordable units required; establishing this percent as the minimum amount presumed feasible; and allowing developers to rebut this presumption with substantial evidence to the contrary); (b) clarify the methodology for feasibility analysis; and (c) reduce the extra basis point cushion.

Thank you for your consideration of our comments. Please do not hesitate to contact me with any questions.

Sincerely,

Susanne Browne
Attorney-at-law

KEYSER MARSTON ASSOCIATES
ADVISORS IN PUBLIC/PRIVATE REAL ESTATE DEVELOPMENT

MEMORANDUM

To: Mr. Santos Kreimann, Chief Administrative Officer
County of Los Angeles

From: James Rabe

cc: Mr. John Edmisten, CAO
Mr. Stan Wisniewski,
Los Angeles County Department of Beaches & Harbors

Date: June 18, 2007

Subject: Legal Aid Letter Dated June 12, 2007

Pursuant to your request, Keyser Marston Associates, Inc. (KMA) has reviewed the submittal from the Legal Aid Foundation of Los Angeles (Legal Aid) dated June 12, 2007 related to the proposed Marina del Rey Affordable Housing Policy. KMA has the following comments and responses to the financial analysis in the Legal Aid submittal.

ANALYSIS

Return on Cost

In their March 6, 2007 letter regarding Parcel 100/101, Legal Aid agreed that current rents and current costs was the correct methodology for measuring return on cost. "When measuring return on cost for new development projects, the assumption is made that the net operating income is based upon a fully stabilized project in today's dollars, and the land value and construction costs (total development costs) are also measured in today's dollars. This definition accords with the standard definition used by real estate economists." (Page 3, first paragraph). It continues to be KMA's and Allan D. Kotin & Associates' position, based on our collective experience in evaluating real estate projects for local governments and private developers in California, that a reasonable developer will require a current return on cost of 7% or higher for an apartment project on leased land with an approximately 60-year lease term and an affordable housing obligation.

Equity IRR

Legal Aid is incorrectly applying the City of Los Angeles Housing Department (LAHD) conclusions. The LAHD analysis utilized a 15% equity IRR threshold. That equity IRR threshold assumed a 10-year operating or holding period and a three-year construction period. It did not assume a sale at the end of three years. Shortening the time period to sale artificially increases the equity IRR.

In addition, KMA notes that the version of the Alexan Marina project for which LAHD computed a 15% equity IRR, generated a 7.3% return on cost using the then current costs and the then current rents. This 7.3% return on cost for a fee ownership rental project is higher than the 7.0% threshold for ground lease project with an approximately 60-year term that KMA has utilized. This demonstrates that the return on cost threshold used by KMA is conservative.

Moreover, LAHD stated that they "believed" that the Alexan Marina project could not support more than 6% very low-income units. LAHD qualified its "belief" by saying, "Although methodologies and assumptions can continue to be debated and alternative conclusions can be reached…" In addition, LAHD noted "both the Mello Act and the City's Interim Administrative Procedures contemplate some mitigation for the loss of profit attendant to providing affordable units.." In other words, the LAHD conclusions assumed: (1) assumed that some type of financial mitigation would be required for a project that had inclusionary units; and (2) that other reasonable assumptions would show that it is infeasible to provide affordable units in the project.

Affordable Rental Rates

In addition, it is our understanding that the very low-income rents used in the LAHD analysis (as well as subsequent analyses) for the City of Los Angeles (City) are approximately equal to the County of Los Angeles (County) low-income rental rates. This means that the City's 10% very low-income requirement is approximately the same as a 10% low-income requirement in the County. A 10% very low-income requirement in the County is much more onerous to a developer than it is in the City.

It is therefore inappropriate for Legal Aid to compare the City's proposed policy to the County's proposed policy because they are based on different rent assumptions.

Financial Attachment

The financial attachments are not consistent with the discussion in the text. There is no IRR analysis. Also the financial analysis does not include the value of the existing leaseholds. This is inappropriate as all of the projects being considered for redevelopment have existing uses that create value for the existing lessees. To ignore this value is contrary to sound economic analysis. Moreover, ignoring this cost artificially increases the equity IRR in the Legal Aid analysis.

In a separate discussion, Legal Aid's consultant indicated that the County's use of an 8% discount rate (or yield requirement) for the existing leaseholds was too low, and that it should be a higher threshold. We note that Real Estate Research Corporation's most recent national survey of real estate returns indicated that the average "first tier" apartment project in the western U.S. was being purchased to yield 8.1%. This demonstrates that the KMA assumptions are consistent with current investment practices.

References to Other Projects

The comparable LA City projects presented by Legal Aid are also all condominium projects. Until recently, there was sufficient profit in the condominium market to allow the developer to include inclusionary units (or to provide them off-site). Most importantly, it appears that the developer of the Alexan Marina project determined that it could not feasibly develop the project as a rental project with an affordable housing component and revised the project to be a condominium project with an affordable housing component. The two rental projects listed are in Marina del Rey and were approved a number of years ago. Moreover, the developer of the Capri Apartments attempted to eliminate the affordable component of its project after completion and instead pay an in-lieu fee. KMA does not believe that these two rental projects are comparable to the current situation.

CONCLUSIONS

KMA believes that the Legal Aid analysis is flawed. They have incorrectly applied the analysis used by other entities and have intentionally ignored legitimate project costs. These flaws allow Legal Aid to argue that projects can afford to provide more affordable housing than they actually can provide. Finally, Legal Aid incorrectly compares the County's affordable housing options to those considered by the City of Los Angeles. Such comparison is unwarranted because the rental rates utilized by the City of Los Angeles are considerably higher than those used by the County.